

(ii) A related S corporation;

(iii) An electing partnership that issues a debt instrument (or is treated as issuing a debt instrument under section 108(e)(4)) in a debt-for-debt exchange described in section 108(i)(2)(A) or a deemed debt-for-debt exchange described in § 1.108(i)-3(a); or

(iv) An electing S corporation that issues a debt instrument (or is treated as issuing a debt instrument under section 108(e)(4)) in a debt-for-debt exchange described in section 108(i)(2)(A) or a deemed debt-for-debt exchange described in § 1.108(i)-3(a).

(25) *OID*. *OID* means original issue discount, as determined under sections 1271 through 1275 (and the regulations under those sections). If the amount of *OID* with respect to a debt instrument is less than a de minimis amount as determined under § 1.1273-1(d), the *OID* is treated as zero for purposes of section 108(i)(2).

(26) *Reacquisition*. A *reacquisition*, with respect to any applicable debt instrument, is any event occurring after December 31, 2008 and before January 1, 2011, that causes COD income with respect to such applicable debt instrument, including any acquisition of the debt instrument by the debtor that issued (or is otherwise the obligor under) the debt instrument or a person related to such debtor (within the meaning of section 108(i)(5)(A)).

(27) *Related partnership*. A *related partnership* is a partnership that is related to the electing entity (within the meaning of section 108(i)(5)(A)) and that issues a debt instrument in a debt-for-debt exchange described in section 108(i)(2)(A) or a deemed debt-for-debt exchange described in § 1.108(i)-3(a).

(28) *Related S corporation*. A *related S corporation* is an S corporation that is related to the electing entity (within the meaning of section 108(i)(5)(A)) and that issues a debt instrument in a debt-for-debt exchange described in section 108(i)(2)(A) or a deemed debt-for-debt exchange described in § 1.108(i)-3(a).

(29) *Separate interest*. A *separate interest* is a direct interest in an electing partnership or in a partnership or S corporation that is a direct or indirect partner of an electing partnership.

(30) *S corporation partner*. An *S corporation partner* is an S corporation

that is a direct or indirect partner of an electing partnership or a related partnership.

(b) *Effective/Applicability dates*—(1) *In general*. The rules of this section, § 1.108(i)-1, and § 1.108(i)-2, apply on or after July 2, 2013, to reacquisitions of applicable debt instruments in taxable years ending after December 31, 2008. In addition, the rules of § 1.108(i)-3 apply on or after July 2, 2013, to debt instruments issued after December 31, 2008, in connection with reacquisitions of applicable debt instruments in taxable years ending after December 31, 2008.

(2) *Prior periods*. For rules applying before July 2, 2013, see § 1.108(i)-0T, § 1.108(i)-1T, § 1.108(i)-2T, and § 1.108(i)-3T, as contained in 26 CFR part 1, revised April 1, 2013.

[T.D. 9622, 78 FR 39986, July 3, 2013; 78 FR 48607, Aug. 9, 2013]

§ 1.108(i)-1 Deferred discharge of indebtedness income and deferred original issue discount deductions of C corporations.

(a) *Overview*. Section 108(i)(1) provides an election for the deferral of COD income arising in connection with the reacquisition of an applicable debt instrument. An electing corporation generally includes deferred COD income ratably over the inclusion period. Paragraph (b) of this section provides rules for the mandatory acceleration of an electing corporation's remaining deferred COD income, the mandatory acceleration of a C corporation issuer's deferred *OID* deductions, and for the elective acceleration of an electing member's (other than the common parent's) remaining deferred COD income. Paragraph (c) of this section provides examples illustrating the application of the mandatory and elective acceleration rules. Paragraph (d) of this section provides rules for the computation of an electing corporation's earnings and profits. Paragraph (e) of this section refers to the effective/applicability dates.

(b) *Acceleration events*—(1) *Deferred COD income*. Except as otherwise provided in paragraphs (b)(2) and (3) of this section, and § 1.108(i)-2(b)(6) (in the case of a corporate partner), an electing corporation's deferred COD income is

taken into account ratably over the inclusion period.

(2) *Mandatory acceleration events.* An electing corporation takes into account all of its remaining deferred COD income, including its share of an electing partnership's deferred COD income, immediately before the occurrence of any one of the events described in this paragraph (b)(2) (mandatory acceleration events), regardless of whether the electing corporation is in a title 11 or similar case at the time the mandatory acceleration event occurs.

(i) *Changes in tax status.* The electing corporation changes its tax status. For purposes of the preceding sentence, an electing corporation is treated as changing its tax status if it becomes one of the following entities:

(A) A tax-exempt entity as defined in § 1.337(d)-4(c)(2).

(B) An S corporation as defined in section 1361(a)(1).

(C) A qualified subchapter S subsidiary as defined in section 1361(b)(3)(B).

(D) An entity operating on a cooperative basis within the meaning of section 1381.

(E) A regulated investment company (RIC) as defined in section 851 or a real estate investment trust (REIT) as defined in section 856.

(F) A qualified REIT subsidiary as defined in section 856(i), but only if the qualified REIT subsidiary was not a REIT immediately before it became a qualified REIT subsidiary.

(ii) *Cessation of corporate existence—*

(A) *In general.* The electing corporation ceases to exist for Federal income tax purposes.

(B) *Exception for section 381(a) transactions—(1) In general.* The electing corporation is not treated as ceasing to exist and is not required to take into account its remaining deferred COD income solely because its assets are acquired in a transaction to which section 381(a) applies. In such a case, the acquiring corporation succeeds to the electing corporation's remaining deferred COD income and becomes subject to section 108(i) and the regulations thereunder, including all reporting requirements, as if the acquiring corporation were the electing corporation. A transaction is not treated as

one to which section 381(a) applies for purposes of this paragraph (b)(2)(ii)(B) in the following circumstances—

(i) The acquisition of the assets of an electing corporation by an S corporation, if the acquisition is described in section 1374(d)(8);

(ii) The acquisition of the assets of an electing corporation by a RIC or REIT, if the acquisition is described in § 1.337(d)-7(a)(2)(ii);

(iii) The acquisition of the assets of a domestic electing corporation by a foreign corporation;

(iv) The acquisition of the assets of a foreign electing corporation by a domestic corporation, if as a result of the transaction, one or more exchanging shareholders include in income as a deemed dividend the all earnings and profits amount with respect to stock in the foreign electing corporation pursuant to § 1.367(b)-3(b)(3);

(v) The acquisition of the assets of an electing corporation by a tax-exempt entity as defined in § 1.337(d)-4(c)(2); or

(vi) The acquisition of the assets of an electing corporation by an entity operating on a cooperative basis within the meaning of section 1381.

(2) *Special rules for consolidated groups—(i) Liquidations.* For purposes of paragraph (b)(2)(ii)(B) of this section, the acquisition of assets by distributee members of a consolidated group upon the liquidation of an electing corporation is not treated as a transaction to which section 381(a) applies, unless immediately prior to the liquidation, one of the distributee members owns stock in the electing corporation meeting the requirements of section 1504(a)(2) (without regard to § 1.1502-34). See § 1.1502-80(g).

(ii) *Taxable years.* In the case of an intercompany transaction to which section 381(a) applies, the transaction does not cause the transferor or distributor to have a short taxable year for purposes of determining the taxable year of the deferral and inclusion period.

(iii) *Net value acceleration rule—(A) In general.* The electing corporation engages in an impairment transaction and, immediately after the transaction, the gross value of the electing corporation's assets (gross asset value)

is less than one hundred and ten percent of the sum of its total liabilities and the tax on the net amount of its deferred items (the net value floor) (the net value acceleration rule). Impairment transactions are any transactions, however effected, that impair an electing corporation's ability to pay the amount of Federal income tax liability on its deferred COD income and include, for example, distributions (including section 381(a) transactions), redemptions, below-market sales, charitable contributions, and the incurrence of additional indebtedness without a corresponding increase in asset value. Value-for-value sales or exchanges (for example, an exchange to which section 351 or section 721 applies), or mere declines in the market value of the electing corporation's assets are not impairment transactions. In addition, an electing corporation's investments and expenditures in pursuance of its good faith business judgment are not impairment transactions. For purposes of determining an electing corporation's gross asset value, the amount of any distribution that is not treated as an impairment transaction under paragraph (b)(2)(iii)(D) of this section (distributions and charitable contributions consistent with historical practice) or under paragraph (b)(2)(iii)(E) of this section (special rules for RICs and REITs) is treated as an asset of the electing corporation. Solely for purposes of computing the amount of the net value floor, the tax on the deferred items is determined by applying the highest rate of tax specified in section 11(b) for the taxable year.

(B) *Transactions integrated.* Any transaction that occurs before the reacquisition of an applicable debt instrument, but that occurs pursuant to the same plan as the reacquisition, is taken into account in determining whether the gross asset value of the electing corporation is less than the net value floor.

(C) *Corrective action to restore net value.* An electing corporation is not required to take into account its deferred COD income under the net value acceleration rule of paragraph (b)(2)(iii)(A) of this section if, before the due date of the electing corporation's return (including extensions),

value is restored in a transaction in an amount equal to the lesser of—

(1) The amount of value that was removed from the electing corporation in one or more impairment transactions (net of amounts previously restored under this paragraph (b)(2)(iii)(C)); or

(2) The amount by which the electing corporation's net value floor exceeds its gross asset value.

For example, assume an electing corporation incurs \$50 of debt, distributes the \$50 of proceeds to its shareholder, and immediately after the distribution, the electing corporation's gross asset value is below the net value floor by \$25. The electing corporation may avoid the inclusion of its remaining deferred COD income if value of at least \$25 is restored to it before the due date of the electing corporation's tax return (including extensions) for the taxable year that includes the distribution. The value that must be restored is determined at the time of the impairment transaction on a net value basis (for example, additional borrowings by an electing corporation do not restore value).

(D) *Exceptions for distributions and charitable contributions that are consistent with historical practice.* An electing corporation's distributions are not treated as impairment transactions (and are not taken into account as a reduction of the electing corporation's gross asset value when applying the net value acceleration rule to any impairment transaction), to the extent that the distributions are described in section 301(c) and the amount of these distributions, in the aggregate, for the applicable taxable year (applicable distribution amount) does not exceed the annual average amount of section 301(c) distributions over the preceding three taxable years (average distribution amount). If an electing corporation's applicable distribution amount exceeds its average distribution amount (excess amount), then the amount of the impairment transaction equals the excess amount. Appropriate adjustments must be made to take into account any issuances or redemptions of stock, or similar transactions, occurring during the taxable year of distribution or any of the preceding three

taxable years. If the electing corporation has a short taxable year for the year of the distribution or for any of the preceding three taxable years, the amounts are determined on an annualized basis. If an electing corporation has been in existence for less than three years, the period during which the electing corporation has been in existence is substituted for the preceding three taxable years. For purposes of determining an electing corporation's average distribution amount, the electing corporation does not take into account the distribution history of a distributor or transferor in a transaction to which section 381(a) applies (other than a transaction described in section 368(a)(1)(F)). Rules similar to those prescribed in this paragraph (b)(2)(iii)(D) also apply to an electing corporation's charitable contributions (within the meaning of section 170(c)) that are consistent with its historical practice.

(E) *Special rules for RICs and REITs*—(1) *Distributions*. Notwithstanding paragraph (b)(2)(iii)(D) of this section, in the case of a RIC or REIT, any distribution with respect to stock that is treated as a dividend under section 852 or 857 is not treated as an impairment transaction (and is not taken into account as a reduction in gross asset value when applying the net value acceleration rule to any impairment transaction).

(2) *Redemptions by RICs*. Any redemption of a redeemable security, as defined in 15 U.S.C. section 80a-2(a)(32), by a RIC in the ordinary course of business is not treated as an impairment transaction (and is not taken into account as a reduction in gross asset value when applying the net value acceleration rule to any impairment transaction).

(F) *Special rules for consolidated groups*—(1) *Impairment transactions and net value acceleration rule*. In the case of an electing member, the determination of whether the member has engaged in an impairment transaction is made on a group-wide basis. An electing member is treated as engaging in an impairment transaction if any member's transaction impairs the group's ability to pay the tax liability associated with all electing members' deferred COD in-

come. Accordingly, intercompany transactions are not impairment transactions. Similarly, the net value acceleration rule is applied by reference to the gross asset value of all members (excluding stock of members whether or not described in section 1504(a)(4)), the liabilities of all members, and the tax on all members' deferred items. For example, assume P is the common parent of the P-S consolidated group, S has a section 108(i) election in effect, and S makes a \$100 distribution to P which, on a separate entity basis, would reduce S's gross asset value below the net value floor. S's intercompany distribution to P is not an impairment transaction. However, if P makes a \$100 distribution to its shareholder, P's distribution is an impairment transaction (unless the distribution is consistent with its historical practice under paragraph (b)(2)(iii)(D) of this section), and the net value acceleration rule is applied by reference to the assets, liabilities, and deferred items of the P-S group.

(2) *Departing member*. If an electing member that previously engaged in one or more impairment transactions on a separate entity basis ceases to be a member of a consolidated group (departing member), the cessation is treated as an impairment transaction and the net value acceleration rule under paragraph (b)(2)(iii)(A) of this section is applied to the departing member on a separate entity basis immediately after ceasing to be a member (and taking into account the impairment transaction(s) that occurred on a separate entity basis). If the departing member's gross asset value is below the net value floor, the departing member's remaining deferred COD income is taken into account immediately before the departing member ceases to be a member (unless value is restored under paragraph (b)(2)(iii)(C) of this section). If the departing member's deferred COD income is not accelerated, the departing member is subject to the reporting requirements of section 108(i) on a separate entity basis. If the departing member becomes a member of another consolidated group, the cessation is treated as an impairment transaction and the net value acceleration rule under paragraph (b)(2)(iii)(A)

of this section is applied by reference to the assets, liabilities, and the tax on deferred items of the members of the acquiring group immediately after the transaction. If the acquiring group's gross asset value is below the net value floor, the departing member's remaining deferred COD income is taken into account immediately before the departing member ceases to be a member (unless value is restored under paragraph (b)(2)(iii)(C) of this section). If the departing member's remaining deferred COD income is not accelerated, the common parent of the acquiring group succeeds to the reporting requirements of section 108(i) with respect to the departing member.

(3) *Elective acceleration for certain consolidated group members*—(i) *In general.* An electing member (other than the common parent) of a consolidated group may elect at any time to accelerate in full (and not in part) the inclusion of its remaining deferred COD income with respect to all applicable debt instruments by filing a statement described in paragraph (b)(3)(ii) of this section. Once made, an election to accelerate deferred COD income under this paragraph (b)(3) is irrevocable.

(ii) *Time and manner for making election*—(A) *In general.* The election to accelerate the inclusion of an electing member's remaining deferred COD income with respect to all applicable debt instruments is made on a statement attached to a timely filed tax return (including extensions) for the year in which the deferred COD income is taken into account. The election is made by the common parent on behalf of the electing member. See §1.1502-77(a).

(B) *Additional information.* The statement must include—

(1) *Label.* A label entitled “SECTION 1.108(i)-1 ELECTION AND INFORMATION STATEMENT BY [INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER OF THE ELECTING MEMBER]”; and

(2) *Required Information.* An identification of each applicable debt instrument to which an election under this paragraph (b)(3) applies and the corresponding amount of—

(i) Deferred COD income that is accelerated under this paragraph (b)(3); and

(ii) Deferred OID deductions that are accelerated under paragraph (b)(4) of this section.

(4) *Deferred OID deductions*—(i) *In general.* Except as otherwise provided in paragraph (b)(4)(ii) of this section and §1.108(i)-2(b)(6) (in the case of a C corporation partner), a C corporation issuer's deferred OID deductions are taken into account ratably over the inclusion period.

(ii) *OID acceleration events.* A C corporation issuer takes into account all of its remaining deferred OID deductions with respect to a debt instrument immediately before the occurrence of any one of the events described in this paragraph (b)(4)(ii), regardless of whether the C corporation issuer is in a title 11 or similar case.

(A) *Inclusion of deferred COD income.* An electing entity or its owners take into account all of the remaining deferred COD income to which the C corporation issuer's deferred OID deductions relate. If, under §1.108(i)-2(b) or (c), an electing entity or its owners take into account only a portion of the deferred COD income to which the deferred OID deductions relate, then the C corporation issuer takes into account a proportionate amount of the remaining deferred OID deductions.

(B) *Changes in tax status.* The C corporation issuer changes its tax status within the meaning of paragraph (b)(2)(i) of this section.

(C) *Cessation of corporate existence*—(1) *In general.* The C corporation issuer ceases to exist for Federal income tax purposes.

(2) *Exception for section 381(a) transactions*—(i) *In general.* A C corporation issuer is not treated as ceasing to exist and does not take into account its remaining deferred OID deductions in a transaction to which section 381(a) applies, taking into account the application of §1.1502-34, as appropriate. See §1.1502-80(g). This exception does not apply to a transaction that is not treated as one to which section 381(a) applies under paragraph (b)(2)(iii)(B)(I) of this section.

(ii) *Taxable years.* In the case of an intercompany transaction to which

section 381(a) applies, the transaction does not cause the transferor or distributor to have a short taxable year for purposes of determining the taxable year of the deferral and inclusion period.

(c) *Examples.* The application of this section is illustrated by the following examples. Unless otherwise stated, P, S, S1, and X are domestic C corporations, and each files a separate return on a calendar year basis:

Example 1 Net value acceleration rule. (i) *Facts.* On January 1, 2009, S reacquires its own note and realizes \$400 of COD income. Pursuant to an election under section 108(i), S defers recognition of the entire \$400 of COD income. Therefore, absent a mandatory acceleration event, S will take into account \$80 of its deferred COD income in each year of the inclusion period. On December 31, 2010, S makes a \$25 distribution to its sole shareholder, P, and this is the only distribution made by S in the past four years. Immediately following the distribution, S's gross asset value is \$100, S has no liabilities, and the Federal income tax on S's \$400 of deferred COD income is \$140. Accordingly, S's net value floor is \$154 ($110\% \times \140).

(ii) *Analysis.* Under paragraph (b)(2)(iii)(A) of this section, S's distribution is an impairment transaction. Immediately following the distribution, S's gross asset value of \$100 is less than the net value floor of \$154. Accordingly, under the net value acceleration rule of paragraph (b)(2)(iii)(A) of this section, S takes into account its \$400 of deferred COD income immediately before the distribution.

(iii) *Corrective action to restore value.* The facts are the same as in paragraph (i) of this *Example 1*, except that P contributes assets with a value of \$25 to S before the due date of S's 2010 return (including extensions). Because P restores \$25 of value to S (the lesser of the amount of value removed in the distribution (\$25) or the amount by which S's net value floor exceeds its gross asset value (\$54)), under paragraph (b)(2)(iii)(C) of this section, S does not take into account its \$400 of deferred COD income.

Example 2 Distributions consistent with historical practice. (i) *Facts.* P, a publicly traded corporation, makes a valid section 108(i) election with respect to COD income realized in 2009. On December 31, 2009, P distributes \$25 million on its 5 million shares of common stock outstanding. As of January 1, 2006, P has 10 million shares of common stock outstanding, and on March 31, 2006, P distributes \$10 million on those 10 million shares. On September 15, 2006, P effects a 2:1 reverse stock split, and on December 31, 2006, P distributes \$10 million on its 5 million shares of common stock outstanding. In each of 2007 and 2008, P distributes \$5 million on its 5 mil-

lion shares of common stock outstanding. All of the distributions are described in section 301(c).

(ii) *Amount of impairment transaction.* Under paragraph (b)(2)(iii)(D) of this section, P's 2009 distributions are not treated as impairment transactions (and are not taken into account as a reduction of P's gross asset value when applying the net value acceleration rule to any impairment transaction), to the extent that the aggregate amount distributed in 2009 (the applicable distribution amount) does not exceed the annual average amount of distributions (the average distribution amount) over the preceding three taxable years. Accordingly, P's applicable distribution amount for 2009 is \$25 million, and its average distribution amount is \$10 million (\$20 million (2006) plus \$5 million (2007) plus \$5 million (2008) divided by 3). The reverse stock split in 2006 is not a transaction requiring an adjustment to the determination of the average distribution amount. Because P's applicable distribution amount of \$25 million exceeds its average distribution amount of \$10 million, under paragraph (b)(2)(iii)(D) of this section, the amount of P's 2009 distribution that is treated as an impairment transaction is \$15 million. The balance of the 2009 distribution, \$10 million, is not treated as an impairment transaction (and is not taken into account as a reduction in P's gross asset value when applying the net value acceleration rule to any impairment transaction).

(iii) *Distribution history.* The facts are the same as in paragraph (i) of this *Example 2*, except that in 2010, P merges into X in a transaction to which section 381(a) applies, with X succeeding to P's deferred COD income, and X makes a distribution to its shareholders. For purposes of determining whether X's distribution is consistent with its historical practice, the average distribution amount is determined solely with respect to X's distribution history.

Example 3 Cessation of corporate existence. (i) *Transaction to which section 381(a) applies.* P owns all of the stock of S. In 2009, S reacquires its own note and elects to defer recognition of its \$400 of COD income under section 108(i). On December 31, 2010, S liquidates into P in a transaction that qualifies under section 332. Under paragraph (b)(2) of this section, S must take into account all of its remaining deferred COD income upon the occurrence of any one of the mandatory acceleration events. Although S ceases its corporate existence as a result of the liquidation, S is not required to take into account its remaining deferred COD income under the exception in paragraph (b)(2)(ii)(B) of this section because its assets are acquired in a transaction to which section 381(a) applies. However, under paragraph (b)(2)(iii)(A)

of this section, S's distribution to P is an impairment transaction and the net value acceleration rule is applied with respect to the assets, liabilities, and deferred items of P (S's successor) immediately following the distribution. If S's deferred COD income is not taken into account under the net value acceleration rule of (b)(2)(iii) of this section, P succeeds to S's remaining deferred COD income and to S's reporting requirements as if P were the electing corporation.

(ii) *Debt-laden distributee.* The facts are the same as in paragraph (i) of this *Example 3*, except that in the liquidation, S distributes \$100 of assets to P, a holding company whose only asset is its stock in S. Assume that immediately following the distribution, P's gross asset value is \$100, P has \$60 of liabilities, and the Federal income tax on the \$400 of deferred COD income is \$140. Under paragraph (b)(2) of this section, S must take into account all of its remaining deferred COD income upon the occurrence of any one of the mandatory acceleration events. Although S ceases its corporate existence as a result of the liquidation, S is not required to take into account its remaining deferred COD income under the exception in paragraph (b)(2)(ii)(B) of this section because its assets are acquired in a transaction to which section 381(a) applies. However, under paragraph (b)(2)(iii)(A) of this section, S's distribution to P is an impairment transaction and the net value acceleration rule is applied with respect to the assets, liabilities, and deferred items of P (S's successor). Immediately following the distribution, P's gross asset value of \$100 is less than the net value floor of \$220 [$110\% \times (\$60 + \$140)$]. Accordingly, under the net value acceleration rule of paragraph (b)(2)(iii)(A) of this section, S is required to take into account its \$400 of deferred COD income immediately before the distribution, unless value is restored to P pursuant to paragraph (b)(2)(iii)(C) of this section.

(iii) *Foreign acquirer.* The facts are the same as in paragraph (i) of this *Example 3*, except that P is a foreign corporation. Although S's assets are acquired in a transaction to which section 381(a) applies, under paragraph (b)(2)(ii)(B)(i)(iii) of this section, the exception to accelerated inclusion does not apply and S takes into account its remaining deferred COD income immediately before the liquidation. See also section 367(e)(2) and the regulations thereunder.

(iv) *Section 338 transaction.* P, the common parent of a consolidated group (P group), owns all the stock of S1, one of the members of the P group. In 2009, S1 reacquires its own indebtedness and realizes \$30 of COD income. Pursuant to an election under section 108(i), S1 defers recognition of the entire \$30 of COD income. In 2010, P sells all the stock of S1 to X, an unrelated corporation, for \$300, and P and X make a timely section 338(h)(10) election with respect to the sale. Under para-

graph (b)(2)(ii)(A) of this section, an electing corporation takes into account its remaining deferred COD income when it ceases its existence for Federal income tax purposes unless the exception in paragraph (b)(2)(ii)(B) of this section applies. Pursuant to section 338(h)(10) and the regulations, S1 is treated as transferring all of its assets to an unrelated person in exchange for consideration that includes the discharge of its liabilities. This deemed value-for-value exchange is not an impairment transaction. Following the deemed sale, while S1 is still a member of the P group, S1 is treated as distributing all of its assets to P and as ceasing its existence. Under these facts, the distribution of all of S1's assets constitutes a deemed liquidation, and is a transaction to which sections 332 and 381(a) apply. Although S1 ceases its corporate existence as a result of the liquidation, S1 is not required to take into account its remaining deferred COD income under the exception in paragraph (b)(2)(ii)(B) of this section because its assets are acquired in a transaction to which section 381(a) applies. P succeeds to S1's remaining deferred COD income and to S1's reporting requirements as if P were the electing corporation. Under paragraph (b)(2)(iii)(F)(i) of this section, the intercompany distribution from S1 to P is not an impairment transaction.

(d) *Earnings and profits*—(1) *In general.* Deferred COD income increases earnings and profits in the taxable year that it is realized and not in the taxable year or years that the deferred COD income is includible in gross income. Deferred OID deductions decrease earnings and profits in the taxable year or years in which the deduction would be allowed without regard to section 108(i).

(2) *Exceptions*—(i) *RICs and REITs.* Notwithstanding paragraph (d)(1) of this section, deferred COD income increases earnings and profits of a RIC or REIT in the taxable year or years in which the deferred COD income is includible in gross income and not in the year that the deferred COD income is realized. Deferred OID deductions decrease earnings and profits of a RIC or REIT in the taxable year or years that the deferred OID deductions are deductible.

(ii) *Alternative minimum tax.* For purposes of calculating alternative minimum taxable income, any items of deferred COD income or deferred OID deduction increase or decrease, respectively, adjusted current earnings under

§ 1.108(i)-2

26 CFR Ch. I (4-1-14 Edition)

section 56(g)(4) in the taxable year or years that the item is includible or deductible.

(e) *Effective/applicability dates.* For *effective/applicability dates*, see § 1.108(i)-0(b).

[T.D. 9622, 78 FR 39987, July 3, 2013; 78 FR 48607, Aug. 9, 2013]

§ 1.108(i)-2 Application of section 108(i) to partnerships and S corporations.

(a) *Overview.* Under section 108(i), a partnership or an S corporation may elect to defer COD income arising in connection with a reacquisition of an applicable debt instrument for the deferral period. COD income deferred under section 108(i) is included in gross income ratably over the inclusion period, or earlier upon the occurrence of any acceleration event described in paragraph (b)(6) or (c)(3) of this section. If a debt instrument is issued (or treated as issued under section 108(e)(4)) in a debt-for-debt exchange described in section 108(i)(2)(A) or a deemed debt-for-debt exchange described in § 1.108(i)-3(a), some or all of the deductions for OID with respect to such debt instrument must be deferred during the deferral period. The aggregate amount of OID deductions deferred during the deferral period is generally allowed as a deduction ratably over the inclusion period, or earlier upon the occurrence of any acceleration event described in paragraph (b)(6) or (c)(3) of this section. Paragraph (b) of this section provides rules that apply to partnerships. Paragraph (c) of this section provides rules that apply to S corporations. Paragraph (d) of this section provides general rules that apply to partnerships and S corporations. Paragraph (e) of this section provides election procedures and reporting requirements. Paragraph (f) of this section contains the effective/applicability date. See § 1.108(i)-0(a) for definitions that apply to this section.

(b) *Specific rules applicable to partnerships—(1) Allocation of COD income and partner's deferred amounts.* An electing partnership that defers any portion of COD income realized from a reacquisition of an applicable debt instrument under section 108(i) must allocate all of the COD income with respect to the ap-

plicable debt instrument to its direct partners that are partners in the electing partnership immediately before the reacquisition in the manner in which the income would be included in the distributive shares of the partners under section 704 and the regulations under section 704, including § 1.704-1(b)(2)(iii), without regard to section 108(i). The electing partnership may determine, in any manner, the portion, if any, of a partner's COD income amount with respect to an applicable debt instrument that is the deferred amount, and the portion, if any, that is the included amount. However, no partner's deferred amount with respect to an applicable debt instrument may exceed that partner's COD income amount with respect to such applicable debt instrument, and the aggregate amount of the partners' COD income amounts and deferred amounts with respect to each applicable debt instrument must equal the electing partnership's COD income amount and deferred amount, respectively, with respect to each such applicable debt instrument.

(2) *Basis adjustments and capital account maintenance—(i) Basis adjustments.* The adjusted basis of a partner's interest in a partnership is not increased under section 705(a)(1) by the partner's deferred amount in the taxable year of the reacquisition. The adjusted basis of a partner's interest in a partnership is not decreased under section 705(a)(2) by the partner's share of any deferred OID deduction in the taxable year in which the deferred OID accrues. The adjusted basis of a partner's interest in a partnership is adjusted under section 705(a) by the partner's share of the electing partnership's deferred items for the taxable year in which the partner takes into account such deferred items under this section.

(ii) *Capital account maintenance.* For purposes of maintaining a partner's capital account under § 1.704-1(b)(2)(iv) and notwithstanding § 1.704-1(b)(2)(iv)(n), the capital account of a partner of a partnership is adjusted under § 1.704-1(b)(2)(iv) for a partner's share of an electing partnership's deferred items as if no election under section 108(i) were made.

(3) *Deferred section 752 amount—(i) In general.* An electing partnership shall